IN THE

Supreme Court of the United States

OCTOBER TERM, 1967

No. 60

FEDERAL POWER COMMISSION,
Petitioner

v.

SUNRAY DX OIL COMPANY, *et al.*

No. 61

THE UNITED GAS IMPROVEMENT COMPANY,
Petitioner

v.

SUNRAY DX OIL COMPANY, *et al.*

No. 62

THE BROOKLYN UNION GAS COMPANY, *et al.*
Petitioners

v.

FEDERAL POWER COMMISSION, *et al.*

No. 80

FEDERAL POWER COMMISSION,
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v.

STANDARD OIL COMPANY OF TEXAS,
A Division of Chevron Oil Company, *et al.*

No. 97

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v.

SUNRAY DX OIL COMPANY

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE TENTH CIRCUIT

REPLY BRIEF FOR RESPONDENTS SUNRAY DX OIL COMPANY, TEXACO INC., SUN OIL COMPANY, SOHIO PETROLEUM COMPANY, EDWIN L. COX, HUMBLE OIL & REFINING COMPANY, LAMAR HUNT, GULF OIL CORPORATION, GEORGE H. COATES, PATCHIN-WILMOTH INDUSTRIES, INC., UNION PRODUCING COMPANY, AND CLARK FUEL PRODUCING COMPANY

January 8, 1968

Names and addresses of Counsel appear on the inside of this cover.

FIDELITY PRINTING COMPANY, INC., HOUSTON

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This brief is filed on behalf of the undersigned producer respondents in Nos. 60, 61, 62, 80 and 97, the *Amerada* cases. We urge affirmance of the judgments of the Court of Ap-

peals for the Tenth Circuit approving the Commission's 16-cent in-line price determination for Texas District No. 4 and reversing the Commission's determination that retroactive refunds could be imposed under validly issued temporary certificates which had become final and contained no provision forewarning of such hidden liability. The issue raised in the *Sinclair* and *Hawkins* cases (Petition No. 143) as to whether a "public need" for acquiring new gas supplies was adequately shown is not present in this case.[1] This brief replies to certain contentions advanced in the initial briefs filed by Brooklyn Union Gas Company, *et al.* (Brooklyn Union) and The United Gas Improvement Company (UGI), collectively referred to as Distributors. Additionally, we respond to the position taken in the initial briefs of the Commission and the Distributors on the retroactive refund issue.

I. THE IN-LINE PRICE ISSUE

Distributors' argument seeking reversal of the Commission's price line determination is that the Commission abused its discretion in considering evidence reflective of "current conditions." Distributors argue that the Commission should have confined itself to evidence found to be limited to a ". . . few isolated and inherently non-representative sales . . ." (I R. 5784). Acceptance of Distributors' position would require freezing the Section 7 in-line price

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[1] In their brief to the Presiding Examiner in the *Amerada* case, the Distributors stated (page 2):

> "The only contested issues in these proceedings are the initial prices at which the producer sales should be permanently certificated and the refunds which should be ordered of those amounts collected under temporary authorizations in excess of the price at which the sales are permanently certificated."

level for a period of over a decade prior to the establishment of just and reasonable rates for the area in question. Such a total disregard for current realities and the price levels required to obtain adequate new gas supplies for the interstate market is totally inconsistent with the Commission's statutory obligation of determining the price required by the "present or future public convenience and necessity."

The Distributors attempt to support their unprecedented position by: (1) labeling price levels higher than those they have unilaterally determined to be acceptable as "untested and essentially unregulated" (Brooklyn Union Br., pp. 27, 28); (2) ignoring evidence of current conditions demonstrating that a price freeze at in-line levels of the 1950's is inconsistent with the present and future public convenience and necessity; and (3) urging that an artificially low in-line price does not penalize the producer since he can exercise his rights under Section 4 of the Act to file up to his original contract price. We hereafter expose the errors underlying such contentions.

A. The Commission's 16 Cent In-Line Price Does Not Represent An Adoption Of "Unregulated" Market Prices

Distributors characterize the Commission's reliance upon temporarily certificated prices and its *Policy Statement*[2] guideline price as a utilization of "untested" and "essentially unregulated" prices inconsistent with the objectives of in-line pricing. This is entirely misleading. The 16-cent in-line price adopted by the Commission for Texas District No. 4 is substantially *below* the weighted average price level

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[2] *Statement of General Policy No. 61-1,* 24 FPC 818 (1960).

under contemporaneously issued certificates[3] and the 18-cent *Policy Statement* price applicable to the pricing period in question. Moreover, the uncontested evidence shows — and the Commission specifically found — that the *Policy Statement* resulted in an overall reduction in the level of contract prices negotiated by Producers with pipeline purchasers (I R. 5788-89). Hence, such prices cannot be properly characterized as "unregulated."

Distributors' argument is factually incorrect in an additional respect: While the weighted average interstate contract level for the time period in question was in excess of 17.176 cents per Mcf (I R. 5786), the Commission established an in-line ceiling price of only 16 cents per Mcf, a level which the Commission found ". . . draws the line substantially below the average going price for gas in the area" (I R. 5790).

In order that the Court will not be misled by the innuendo prevading the Distributors' brief labeling the Commission's 16-cent in-line price as "potentially excessive," (Brooklyn Union Br., p. 21) we respectfully request the Court to take notice that the Commission, in its *Permian Basin* opinion and order,[4] found the national average current cost of finding and producing gas supplies in 1960 to be 16.43 cents per Mcf (34 FPC 159 at 192). Distributors, however, never explain how a 16-cent in-line price, viewed in this light, can reasonably be labeled "excessive."

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[3] In its brief, Brooklyn Union (p. 10, fn. 4) claims without record citation that the Staff witness who sponsored the price line exhibit (Exhibit 16) "rationalized" the absence of sales below 14 cents because no party was contending for a price line of less than 14 cents and it reduced the "magnitude" of the task of preparing the exhibit. This is flatly refuted by the witness's uncontradicted testimony that he considered those sales irrelevant (I R. 1130).

[4] 34 FPC 159 (1965), pending before the Court in Nos. 90, *et al.*, this Term.

B. The Legal Authorities Relied On By Distributors Do Not Support The Position That Consideration Of "Current Conditions" Is Irrelevant To In-Line Pricing

In support of their position that a consideration of current conditions in the natural gas industry is irrelevant to the present or future public convenience and necessity, Distributors rely upon the D. C. Circuit's opinion in *Sinclair-Hawkins.*[5] The court there held that in-line pricing should not depend upon current conditions ". . . unless, in a particular case, there is something special about these conditions . . ." (373 F. 2d at 829). The "something special" referred to by that court goes directly to the heart of the Commission's decision in this case, *i.e.,* the attraction of the necessary capital prerequisite to the search for adequate new gas supplies. However, Distributors have *excluded* the following pertinent passage from that court's opinion quoted at page 30 of Brookyn Union's brief:

> "For example, in a particular case, the FPC may feel that *an in-line price which is too low subjects the producers to too much risk. And this risk may endanger investment in the industry.*"[6]

It is the consumer who is economically injured if the Commission has permitted the supply-demand relationship to become out of balance through the freezing of prices at unrealistically low levels. The responsibility of the Commission to provide consumers with adequate supplies at a reasonable price requires that it have the flexibility to make adjustments to the in-line price levels in response to shifts in conditions and relative excesses or shortages in supply

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[5] *Public Service Commission of New York* v. *Federal Power Commission,* 373 F.2d 816 (D.C. Cir. 1967).

[6] Emphasis supplied unless otherwise indicated.

levels. Such flexibility is not possible under a system of pricing designed simply to freeze price levels established for the 1950's.

The economic and financial requirements evidence proffered by Producers, and summarized in Appendix B to our initial brief, demonstrates in some detail the changing conditions in the industry which required an upward revision in the Commission's prior 15-cent in-line price determination. The Commission excluded this evidence solely on the basis of ". . . the need to expedite the determination of the price line" (Commission Br., p. 27). The Commission, however, concluded that the basic economic forces operating within the industry (which were analyzed in detail by such excluded evidence) were directly reflected in the more generalized price line evidence which it utilized. To the extent the Court may seek greater detail on the shifts in current industry conditions which required the Commission to revise it earlier 15-cent in-line price, we respectfully refer it to the evidence proffered by the Producers.[7] It shows *inter alia*:

1) The U. S. Bureau of Labor Statistics indicate the retail price of natural gas has lagged behind prices of alternative fuels (I R. 1308-09);

2) Reports by the Texas Railroad Commission and the annual reports by pipelines to the Commission demonstrate a sharp decline in the percentage of Texas Gulf Coast gas sold in interstate commerce and a corresponding increase in intrastate deliveries (I R. 1331-32); and

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[7] The exclusion of this evidence is the issue raised by a conditional cross-petition currently pending as No. 82, this Term. Although such evidence has not been printed in the appendix filed in this Court, it does appear in the Joint Appendix and related exhibit volume filed in the court below, copies of which have been lodged with the Clerk and are available to the Court.

3) Statistics regularly published by the American Gas Association and the American Petroleum Institute disclose a steady decline in the ratio of new supplies to net production, particularly in Texas (I R. 1271-72).

Absent the ability to utilize its expertise in analyzing the various price line data received in evidence as a barometer of such trends, the Commission would have been prohibited, short of a more lengthy evidentiary hearing, from responding to such indicia and insuring the maintenance of adequate gas supplies for the expanding consumer market.[8]

C. Rate Increase Filings Under Section 4(e) Do Not Provide Protection From An Unreasonably Low In-Line Price

Distributors also attempt to support their price freeze position by arguing that a producer can escape the inequities of an artificially low initial price through subsequent rate increase filings under Section 4 of the Natural Gas Act (Brooklyn Union Br., pp. 30-31). Distributors fail to mention, however, that the Commission frequently imposes conditions in both temporary and permanent certificates prohibiting rate increase filings above certain levels or during a certain prescribed moratorium period. (See brief of Shell Oil Company, *et al.*, in Nos. 60, *et al.*, 111, and 143, pp. 38-40.) Even assuming that producers were not pre-

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[8] Although it is inconsistent with their basic premise that current conditions are irrelevant in in-line pricing, Distributors claim that the period during which these contracts were executed was "generally accepted" as being one of "excess supply" (Brooklyn Union Br., p. 31, fn. 16). This allegation, presumably designed to justify a price freeze, is not supported by any evidentiary presentation of Distributors. Moreover, it is contradicted by the evidence of record and the economic testimony proffered by Producers which Distributors successfully fought to exclude (I R. 5776).

cluded from filing for increased rates, in the event an artificially low initial price were adopted, they would nevertheless be subjected to the following irreparable losses:

1. Under the notice and suspension provisions of Section 4 of the Act, the producer generally cannot place proposed rate increases into effect for a period of six months after the date of filing. During this period, the amount collected is frozen at the initial price level. In the event the increased rate level is found to be justified, no mechanism is available for recouping the loss incurred during the six-month notice and suspension period.

2. The measure of any refunds of amounts collected under temporary certificates containing a refund condition is not by reference to the eventual just and reasonable rate, but solely to the in-line price established at the time of permanent certification. In such circumstances, if the in-line price is established at an artificially low level, refunds will be required of amounts which in all probability will ultimately be determined to have been just and reasonable. There is no procedure by which such losses can be recouped.

3. The in-line price established for these sales will apply to all amounts collected from March 23, 1964 (the date of the Commission's order below) to date. No rate increase filings under Section 4(e) would be permitted on a retroactive basis covering such period. Combined with the effect of (2) above, adoption of Distributors' 15-cent price freeze position would limit producers to receiving only 15 cents for as long as the first *eight* years of deliveries (covering approximately *one-half* of the committed reserves) with no opportunity to recover the difference between such artificially low price and any higher just and reasonable rate which may ultimately be established.

4. Until such time as a just and reasonable rate is determined (which may be more than a decade after the sale commences), a producer collecting an increased

rate subject to refund has no way of knowing what portion of the increase above the in-line level of permanent certification may ultimately be retained. This uncertainty is, of course, aggravated when the permanently certificated price is set at an artificially low level. Such uncertainty creates substantial problems for the producer in settling with royalty interest owners, state taxing authorities, and other interest owners in his property. Moreover, producing properties are frequently sold or utilized as security in financing new drilling projects. Such a contingent refund obligation creates a substantial restraint upon the alienation of such property and impedes its development.

5. A regulatory procedure which will create contingent refund obligations of this type upon new sales will choke off new investment in gas exploration projects. An investor would have no way of determining the return available from an investment in gas properties compared to the many alternative business opportunities competing for capital funds. The real loser, of course, will be the gas consumer who has a substantial investment in gas appliances and, absent adequate producer investment, will not be able to obtain necessary future gas supplies.

The in-line technique developed by the Commission is a practical solution to a vexing interim problem — the derivation on an expedited basis of appropriate certificating pricing levels for areas in which no just and reasonable area rate yet has been determined. In-line pricing requires balancing the desirability of a full record development of the factors relevant to a price line determination against the necessity for prompt Commission response to changing industry conditions. Under such a procedure, considerable deference must be given to agency expertise if the Commission's findings are supported by substantial evidence. *People of State of California* v. *Federal Power Commission*, 353 F.2d 16, 22 (9th Cir. 1965). The net effect of

Distributors' position is to ask this Court to substitute its judgment for that of the Commission's on a highly complex issue requiring the balancing of many offsetting factors on the basis of an abbreviated record shaped by the demands of expedition. Under such circumstances, judicial restraint is clearly appropriate.

II. THE CONTENTIONS ADVANCED IN JUSTIFICATION OF THE RETROACTIVE IMPOSITION OF REFUND LIABILITIES ARE ERRONEOUS

A. Introduction

The attempts of the Commission and Distributors to justify the retroactive imposition of refund liabilities upon lawful temporary certificate orders proceed from various invalid premises. These are highlighted by the Commission's position that no "rational businessman" should have relied upon its orders issuing temporary certificates (Commission Br., p. 48). Such a contention only impugns the integrity of the administrative process and is contradicted by the finding of the Commission itself in this case that Producers had acted "in justifiable reliance" upon these temporary certificates and that the subsequent imposition of refund liabilities would "so denature the value of a commission authorization as to place any reliance upon our actions in this area in serious jeopardy" (I R. 5305-06). It is astounding that the Commission, particularly in view of the necessity for reliance upon its decisions which fair and effective regulation requires, would affirmatively seek to create such a gigantic credibility gap.[9]

[9] For example, the two-price system adopted by the Commission in its *Permian Basin* decision is premised upon the Commission's express representation that the "new gas" incentive price there established can be relied upon by producers and will not thereafter be reduced, *Area Rate Proceeding,* Docket No. AR61-1, 34 FPC 159, 188 (1965).

Brooklyn Union argues that since the Commission "neglected" to forewarn Producers of the possibility of refunds, it should not be precluded from imposing refunds retroactively (Brooklyn Union Br., pp. 35-36). This is a wholly misleading characterization because the absence of refund conditions in these temporary certificates cannot be attributed to Commission "neglect" when, by its own order of February 5, 1963, the Commission expressly found that "it would be contrary to the public interest, as well as inequitable" to impose refund conditions upon these certificates (I R. 5307).

The Commission and Distributors deliberately ignore the particular circumstances in which these temporary certificates were issued and relied upon. Their briefs are limited to generalizations which have no applicability to the facts of this case. They also ignore the Commission's assurances to both the Producers and Distributors that the temporary certificates in question authorized the collection of firm prices during the period of temporary certification. In our initial brief we have discussed in detail the unlawfulness of the Commission's imposition of retroactive refund liabilities upon Producers' temporary certificates. We here respond briefly to certain contentions of the Commission and Distributors in order to place them in proper context.

B. Substantial Benefits Flow To Pipelines, Distributors And Consumers As A Result Of Temporary Certificates

Distributors claim that temporary certificates are issued by the Commission "... for the *sole function* of 'bailing out' an individual producer from a business emergency ..." (UGI Br., p. 17). This attempt to strip temporary certificates of any public-interest function is merely a collateral attack upon the temporary certificate orders. Under these circumstances, we believe a brief recitation of the need for temporary certification in producer regulation is required.

No participant in the *Amerada* proceeding is contesting the need of the pipelines — and therefore of the ultimate consumers — for the gas sold pursuant to the sales certificated in this proceeding. As temporary certificated sales accounted for fully 90 percent of the gas committed to the interstate consumer during the relevant time period, absent the issuance of temporary certificates, practically all of the new interstate gas from this important supply area would not have flowed into interstate commerce, if at all, until permanent certificates were issued in March of 1964. Thus, deliveries would have been delayed up to three and one-half years from the time the contracts for these admittedly needed supplies had been made with the particular pipelines (I.R. 5306). By making deliveries under the temporary certificates issued, Producers irrevocably dedicated their gas to the interstate market and thereby assured that the public need for the gas would be satisfied and maintained.

Under Section 157.28(c) of the Commission's Regulations, 18 CFR 157.28(c), temporary certificates may be issued upon the applicant's sworn showing of a defined emergency situation. These regulations recognize such situations as drainage, threatened loss of lease and flaring. Basically, UGI contends that these regulations are not in the public interest because the standards do not cover situations "injuring consumers or threatening loss of gas to the interstate market" (UGI Br., p. 8).[10] On the contrary, drainage experienced by a producer may be caused by an offsetting well delivering gas to a nonjurisdictional market. Thus, in the absence of a temporary certificate, the interstate well would remain shut in and the gas would flow to the opened intrastate well and thus be lost to the

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[10] However, these regulations were judicially sanctioned in *Public Service Commission of New York* v. *F.P.C.*, 327 F.2d 893 (D.C. Cir. 1964).

interstate market. This is particularly significant in the Texas Gulf Coast Area where 52 percent of the gas flows under nonjurisdictional contracts (III R. 223). Similarly, gas can be lost to the interstate market in situations where a producer loses his lease because of an inability to market the gas. In such a situation, the producer no longer has property to dedicate to the interstate market. It is also perfectly obvious that the public benefits from the issuance of temporary certificates to prevent flaring or the wasteful burning of natural gas in the atmosphere. Flared gas reaches no market.

The presence of an active and rapidly expanded intrastate market in the Texas Gulf Coast area also brings into focus the interstate consumers' interest in having the interstate market economically competitive with the intrastate market. The failure of the Commission to provide for release from what are acknowledged economic hardships, coupled with the normal regulatory time lag involved in obtaining Commission approval for a sale, would have added to the unattractiveness of the interstate regulated market and would have resulted in producers more actively searching for intrastate markets for their gas rather than waiting approximately three years for permanent certification before being able to sell their product.

C. The Terms Of Temporary Certificate Orders Are Judicially Reviewable And Become Final In The Absence Of Judicial Review

The Commission and Distributors variously contend that temporary certificate orders are not final orders and, therefore, confer no rights upon the certificate holder. These erroneous characterizations are obviously designed to bring the retroactive refund question within the ambit of this Court's decision in *United Gas Improvement Co.* v. *Callery Properties, Inc.*, 382 U.S. 223 (1965) (*Callery*). There, the

Court affirmed the Commission's imposition of refund liabilities upon certain amounts previously collected pursuant to non-final permanent certificate orders which had been nullified as the result of judicial review. In this context, the Court upheld the Commission's action on the ground that an agency "can undo what is wrongfully done by virtue of its order" (382 U.S. at 229). By contrast, however, it cannot properly be contended that the temporary certificate orders at issue and the action taken in reliance upon them are in any way "wrong." These orders are valid orders which have become final as a matter of law.

Brooklyn Union attempts to create the impression that prior to the Commission's *Shelly* decision in 1962 (28 FPC 401), the Commission had made clear that the initial prices authorized by its temporary certificate orders were always subject to retroactive modification upon permanent certification (Brooklyn Union Br., p. 33). The error of this contention is demonstrated by the inapposite FPC decisions cited by Brooklyn Union involving either refund liabilities based upon *specific* refund conditions attached to the temporary certificates,[11] or liabilities arising from the collection of amounts under permanent certificates which had been *invalidated* before becoming final.[12]

It is indisputable that the terms of temporary certificate orders issued by the Commission are judicially reviewable and, in the absence of timely review, these terms become final and binding, *Texaco Inc.* v. *Federal Power Commission*, 290 F. 2d 149, 156-57 (5th Cir. 1961). Indeed, on review of permanent certificate orders issued to certain producers in *Texaco*, the court of appeals held that it lacked jurisdiction to entertain producers' attack upon the terms of previously

[11] 23 FPC 369, 378 (*El Paso*); 27 FPC 96 (*Continental Oil*).

[12] 26 FPC 532, 27 FPC 347 (*Socony Mobil*); 27 FPC 15, 482-83 (*Texaco - Seaboard, Inc.*).

issued temporary certificates since timely review of the temporary certificate orders had not been sought.

The Commission's order of February 5, 1963 has also become final (I R. 5305-07).[13] In their briefs, neither Brooklyn Union nor UGI even mentions this order which refused to impose refund conditions upon the temporary certificates issued to Producers. The Commission attempts to evade the effect of this highly significant order[14] by now speculating that the purpose of Distributors' motion was merely to seek the "supplemental protection" of the imposition of an explicit refund condition upon Producers' temporary certificates (Commission Br., pp. 40-41, fn. 28). The determinative fact is that the Commission treated it as an application for rehearing of the temporary certificates, requesting either their vacation or the imposition of refund conditions upon them. Thereafter, Distributors chose not to seek judicial review of this definitive order which reaffirmed that the temporary certificates had been issued "without condition as to refund" and had authorized the collection of the initial certificated prices subject only to prospective modification (I R. 5305).[15] Thus, the "upset administrative order" doctrine of *Callery* has no applicability here.

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[13] As previously indicated, however, Producers do not concede that the Commission is empowered to modify temporary certificates after the time for their judicial review has passed (see our initial brief, p. 41, fn. 40).

[14] A similar order issued by the Commission in *J. Ray McDermott*, 28 FPC 1300, was reviewed and affirmed by the District of Columbia Circuit in *Public Service Commission of New York* v. *F.P.C.*, 327 F.2d 893 (1964).

[15] The fact that the order was issued on the basis of a contested motion did not insulate it from judicial review. This Court's decisions in both *United Gas Pipe Line Co.* v. *Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *United Gas Pipe Line Co.* v. *Memphis Light, Gas & Water Div.*, 358 U.S. 103 (1958), were reviews of F.P.C. orders denying motions. See also *Trans World Airlines, Inc.* v. *C.A.B.*, 339 F. 2d 56, 63 (2d Cir. 1964), *cert. denied*, 882 U.S. 842.

The Commission and Distributors speak as though temporary certificate orders are meaningless except insofar as they permit producers to dedicate their gas irrevocably[16] to the interstate market. This is most misleading. Producers have on various occasions learned to their irremediable detriment that the terms of a temporary certificate are not subject to retroactive change contingent upon the terms of the permanent certificate. Thus, although the Commission and Distributors allude in general terms to those situations where the temporarily certificated price is higher than the price authorized at the time of permanent certification, they fail to mention the cases where the initial price authorized by the temporary certificate is *less* than the price authorized upon permanent certification, *Standard Oil Co. of California*, 27 FPC 1153, 1155, 1161, (1962), aff'd *California Oil Company* v. *Federal Power Commission*, 315 F.2d 652, 654 (10th Cir. 1963); *Shell Oil Co.*, 32 FPC 34, 35, 41 (1964), aff'd, *People of the State of California* v. *Federal Power Commission*, 353 F.2d 16 (9th Cir. 1965);[17] *Texaco Inc., et al.*, 33 FPC 1228 (1965).[18] In those cases, the Commission

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[16] The temporary certificate orders uniformly provide that once service is commenced thereunder, it may not be discontinued without Commission approval. This is in accord with the requirements of Section 7(b) of the Natural Gas Act, 15 U.S.C. 717f(b).

[17] In the *Shell* case, the temporary rate was fixed at 15 cents per Mcf, but the sales involved were later permanently certificated at 17.7 cents per Mcf (32 FPC at 35).

[18] In the *Texaco* case, the Commission granted 233 permanent certificates to numerous producers, including some of the producers involved in the case-at-bar, authorizing the collection of their initial contract prices inclusive of an upward price adjustment for the Btu content of the gas delivered in excess of 1000 Btu per cubic foot. In general, the upward price adjustment based upon Btu content approximated 2 cents per Mcf. And yet, many of these producers sold their gas under temporary certificates issued several years earlier upon the condition that "the upward Btu price adjustment clause shall be eliminated from the subject gas sales contract." A typical temporary certificate to this effect is attached as Appendix "A" to this brief.

did not undertake to "undo what [was] wrongfully done" by retroactively increasing the temporary certificate rates, nor was it empowered to do so.

As discussed in our initial brief, the temporary certificate orders, issued in implementation of the Commission's *Policy Statement,* and the Commission's order of February 5, 1963 herein are final orders upon which Producers have relied to their detriment. Moreover, these temporary certificates authorizing firm initial prices at levels at or below the applicable *Policy Statement* level were the product of a carefully considered and articulated regulatory policy of the Commission. Significantly, the Commission has never claimed that its retroactive modification of the terms of these temporary certificates constitutes an attempt to correct inadvertent error of a ministerial nature. Its action is nothing more than an effort to give retroactive effect to a newly instituted policy regarding temporary certificates.[19] In this regard, the following language of this Court in *American Trucking Associations, Inc.* v. *Frisco Transportation Company,* 358 U.S. 133, 146 (1958) is controlling:

> "Of course, the power to correct inadvertent ministerial errors may not be used as a guise for changing previous decisions because the wisdom of those decisions appears doubtful in the light of changing policies * * *."

The question here is whether the agency here has the power to undo conclusive orders which were not the result of inadvertent error, but rather the implementation of a clearly articulated policy.

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[19] See FPC Order No. 336, 28 F.R. 2844 (1967), 18 C.F.R. § 2.63, which provides for the imposition of express refund conditions upon all temporary certificate orders issued after February 9, 1967.

D. The D. C. Circuit's *McDermott* And *Skelly* Decisions Provide No Lawful Basis For The Commission's Refund Order In This Case

Brooklyn Union and UGI argue that the D.C. Circuit's separate decisions in *McDermott*[20] and *Skelly*[21] should be read in tandem as establishing the law of the Commission's obligation to require refunds in this case (Brooklyn Union Br., p. 34; UGI Br., pp. 11-12).

In *McDermott* the D.C. Circuit reviewed three separate Commission orders[22] granting temporary certificates reducing the proposed prices of 23.675 cents per Mcf to the South Louisiana *Policy Statement* level of 21.25 cents per Mcf.[23] The Commission held there that in granting the temporary certificates at the *Policy Statement* level it had authorized the producer "to sell gas to meet the emergency condition involved while at the same time the consumer is assured of the availability of new sources of gas at stable prices." Additionally the Commission held that by reducing the proposed rates to the *Policy Statement* level, it was permitting the sale, "but only at the price fixed by the Commission as being in the public interest" (28 FPC at 1303). The

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[20] *Public Service Commission of New York* v. *F.P.C.*, 327 F.2d 893 (1964). "McDermott" is the popular name given to this case because of the title of the Commission's order reviewed by the D.C. Circuit.

[21] *Public Service Commission of New York* v. *F.P.C.*, 329 F.2d 242 (1964).

[22] *J. Ray McDermott & Company*, Docket No. CI63-301, 28 FPC 563, rehearing denied 28 FPC 1300; *Placid Oil Company*, Docket No. CI63-305, 28 FPC 565; *E. Cockrell Jr., et al.*, Docket No. CI63-326, 28 FPC 562.

[23] These reductions were expressly ordered pursuant to the Commission's Fourth Amendment to its *Policy Statement*, establishing a 21.25 cent ceiling for new sales in South Louisiana (26 FPC 661).

D.C. Circuit affirmed the Commission because it had been neither arbitrary nor unreasonable (327 F.2d 893, 897).[24] The Distributors' contention is that despite the judicial affirmance of those orders, they are still subject to *retroactive* modification upon permanent certification. If the D.C. Circuit had intended that result, it could not have fairly or even reasonably *affirmed* the Commission's orders.[25]

In *Skelly* the D.C. Circuit faced the refund problem for the first time and concluded that the Commission could order refunds, if the equities in the case so required. In so doing, it expressly noted the conflict of its decision[26] with the prior law established by the Tenth Circuit five years earlier in *Sunray Mid-Continent Oil Co.* v. *F.P.C.*, 270 F. 2d 404 (1959). The D.C. Circuit ignored, however, the fact that the Commission itself had expressly determined to follow the *Sunray Mid-Continent* decision by issuing temporary certificates with conditions of "such certainty as to allow the exercise of choice." *Area Rate Proceeding,* 29 FPC 223 at 225 (1963); *Amerada Petroleum Corporation,* 29 FPC 218 at 220 (1963). *Sunray Mid-Continent* did not preclude the imposition of conditions upon temporary certificates. Rather, it required that if conditions

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[24] This was in accord with the Fifth Circuit's decision in *American Liberty Oil Co.* v. *F.P.C.*, 301 F.2d 15 (1962), holding that an adequate basis existed to condition a temporary certificate to the applicable *Policy Statement* level.

[25] By contrast, where the Commission's certificate orders have been set aside on judicial review, the Commission has successfully argued that because they were judicially invalidated, refunds could be ordered, *U.G.I.* v. *Callery Properties, Inc.*, 382 U.S. 223. In this case, the Commission is seeking the additional power to order refunds although its orders became final in the absence of judicial review. The Distributors' interpretation of *McDermott* suggests that the Commission could order refunds even where the Commission's orders are judicially affirmed.

[26] 329 F.2d at 250, fn. 8.

were to be imposed upon temporary certificates, the Commission must do so at the time of their issuance and in such terms as to permit the producer to make an intelligent choice whether to accept or reject the proffered certificate. This Court recognized in *CATCO* the producer's right to reject conditional certificates (360 U.S. at 387-88). But if certificates may be conditioned after acceptance and on a retroactive basis, a clear case of entrapment results (see I R. 5306) and the producers' right to a choice between acceptance or rejection is a sham.

In *Skelly*, the D.C. Circuit concluded that the Commission could, under Section 7, retroactively impose refund obligations because "[i]t would need to be quite clear from the Act that the Commission lacked the power to use such a remedy for the courts to deny it" (329 F.2d at 249). This erroneously *assumed* an affirmative grant of power to take retrospective action because there was no statutory prohibition. This Court has held, however, that a "retrospective operation will not be given to a statute * * * unless such be 'the unequivocal and inflexible import of the terms and the manifest intention of the legislature,' " *Union Pacific Railroad Company* v. *Laramie Stock Yards Company*, 231 U.S. 190, 199 (1913). By contrast, Section 4 of the Natural Gas Act affirmatively empowers the Commission to adjust suspended rates retroactively, but it cannot be said, in the absence of an "unequivocal" and "manifest intention," that Congress granted the Commission such a retroactive power under Section 7 of the Act.

In the absence of an affirmative grant of power to take retroactive action under Section 7, we respectfully submit that no such power can be implied. Although the Commission argues that there is "no statutory bar" to the imposition of retroactive refunds under this Section, it cites this Court's *Callery* decision in support (Commission Br., p. 41). However, the Commission's power to impose refunds in

that case did not derive from Section 7. In *Callery*, the rates which the Commission had initially authorized had been judicially invalidated. This Court expressly agreed with the Fifth Circuit that in such situation the Commission has an "inherent power" (335 F.2d at 1019) to undo the wrong caused by its illegal order. Thus, this Court rested its decision upon an agency's inherent power to correct an invalid order, but not upon holding that Section 7 of the Natural Gas Act authorizes the retroactive modification of a valid order which has become final.

E. The Question Of The Commission's Exercise Of Its Asserted Retroactive Refund Power In *Amerada* Opinion No. 501 Is Prematurely Raised

The Commission and UGI contend that the Court should also now review the reasonableness of the exercise of the Commission's claimed power to impose retroactive refund liabilities upon Producers. As demonstrated in this and our initial briefs, we dispute that the Commission possesses such power. In any event, the many legal and equitable issues raised in the subsequent appeal of the Commission's Opinion No. 501 should not be entertained by this Court at this time.

After Producers filed their individual petitions for review of Opinion No. 501 (*i.e.*, the exercise of the claimed refund power), the many issues raised by those review petitions were not even briefed, much less passed upon by the Tenth Circuit. Indeed, when that court summarily disposed of these appeals on the basis of its prior *Sunray DX* decision (370 F.2d 181), there was nothing before it except the review petitions themselves and the Commission's "Certificate of Record in Lieu of Record."[27]

[27] This latter compilation was not the record before the Commission, but constituted merely a listing, by title only, of the various pleadings, documents, and orders relating to Opinion No. 501.

In these circumstances, it is no wonder that the Tenth Circuit did not undertake a review of the many subsidiary questions relating to the reasonableness of the Commission's exercise of its claimed refund power. First, the Tenth Circuit held that "[b]ecause we believe that the Commission lacks such power, we are not concerned with the exercise of the power" (376 F.2d at 580). The Tenth Circuit also noted that "[t]he Commission represented to us that the issue of power was severable from the issue of the exercise of the power and urged us to make summary disposition of the power issue" in the interest of prompt disposition of the power question raised by its petition for certiorari to this Court in No. 60, this Term (376 F.2d at 581). This representation was undoubtedly an important reason for the Tenth Circuit's summary disposition of the review petitions. The Tenth Circuit did not refuse to review the substantive questions raised by Producers, but noted rather that if it be held that the Commission does possess such power, "we are ready to consider then the manner of the exercise of the power" (376 F.2d at 581). In similar circumstances, the Court has often recognized the advantage of a prior disposition of a substantive issue of this type by the intermediate appellate court, especially in the case of judicial review of administrative decisions. For example, the Court held in *Civil Aeronautics Board* v. *American Air Transport, Inc.*, 344 U.S. 4, 5 (1952):

> "* * * This Court does not normally review orders of administrative agencies in the first instance; and the Court does not desire to take any action at this time which might foreclose the possibility of such review in the Court of Appeals."[28]

[28] In its recent decision in *F.P.C.* v. *United Gas Pipe Line Company, et al.*, 386 U.S. 237 (1967), this Court reaffirmed that it does not consider it appropriate to decide in the first instance

It should also be stressed that review, in the first instance, by this Court of the many questions relating to the exercise of the claimed refund power will not result in refunds being made in the near future. By its Opinion No. 501, the Commission specifically ordered the Producers to retain or place in escrow the amounts ordered to be refunded (II R. 6228) in recognition of the need for further proceedings before the Commission concerning the question of a flow-through by the pipeline purchasers of the refunds imposed upon Producers. See *Texas Eastern Transmission Corp.* v. *Federal Power Commission,* 357 F. 2d 352 (5th Cir. 1966); *United Fuel Gas Co.* v. *Federal Power Commission,* 367 F. 2d 34 (4th Cir. 1966).

Importantly, the principal authority cited by the Commission in support of Opinion No. 501 is its *Skelly* Opinion No. 492[29] issued on remand from *Public Service Commission of New York* v. *F.P.C.,* 329 F. 2d 242 (D.C. Cir. 1964). But Opinion No. 492 is now pending before the court of appeals following briefing and argument on the various petitions seeking review of the Commission's exercise of its claimed refund power in that case, *Skelly Oil Company, et al.,* v. *Federal Power Commission,* Nos. 9000, *et al.* (10th Cir.). With the agreement of the Solicitor of the Commission, the court is withholding its decision in the *Skelly* appeals abid-

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an issue "to which the Court of Appeals has not addressed itself" (386 U.S. at 247). See also: *Federal Communications Commission* v. *WJR, The Goodwill Station, Inc.,* 337 U.S. 265, 285 (1949); *Abbott Laboratories, et al.* v. *Gardner,* 387 U.S. 136, 156 (1967). *Cory Corporation, et al.* v. *Sauber,* 363 U.S. 709, 712, (1960); *Salem* v. *United States Lines Company,* 370 U.S. 31, 38 (1962); and *United States* v. *Republic Steel Corporation,* 372 U.S. 482, 493 (1960).

[29] *Skelly Oil Co.,* 35 FPC 849 (1966).

ing the outcome of the instant litigation involving the resolution of the basic threshold question of the Commission's power.[30]

In these circumstances, this Court should not undertake review of the Commission's exercise of its claimed refund power in its Opinion No. 501 at this time.

F. The Commission's Exercise Of Its Claimed Retroactive Refund Power Is Not Supported By Substantial Evidence And Constitutes An Abuse Of Discretion, Assuming *Arguendo* That Such Power Exists

Assuming that the Court should decide to review the question of the Commission's exercise of its claimed refund power in its present inchoate form, it must necessarily examine all of the issues raised by the Producers in their petitions for review of Opinion No. 501 filed below.[31] The following are the major issues raised by these eleven separate petitions:

1. Whether the Commission improperly denied Producers the opportunity to present the following evidence demonstrating that the retroactive imposition

[30] The underlying factual questions concerning the Commission's exercise of the refund power in its *Skelly* Opinion No. 492 are not identical with those present in the instant litigation. It is reasonable to assume, however, that the court of appeals' review of Opinion No. 492 will be beneficial to the expeditious resolution of issues raised by Producers on review of Opinion No. 501, if that question is ultimately found to be relevant.

[31] These petitions were lodged in this Court by the Solicitor General with the filing of the Petition in No. 80, this Term.

of a refund condition on the sales at issue is contrary to the public convenience and necessity:[32]

a. The extent to which Producers relied upon the unconditioned temporary certificates granted by the Commission in determining whether to dedicate their gas to interstate commerce.

b. The impact upon Producers of requiring retroactive refunds.

c. The effect of the Commission's action upon the producing industry from the standpoint of planning, budgeting and financing future drilling and production activities.

d. The extent to which such refunds would actually reach the ultimate consumer.

2. Whether the Commission's conclusion that refunds should be required can be justified in light of its acceptance as fact of the following allegations:

a. that the ordering of refunds will have a substantially adverse effect upon the ability of natural gas producers to assure consumers of an adequate supply of natural gas.

b. that a substantial portion of the monies ordered to be refunded will never reach the ultimate consumer.

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[32] When the Commission announced its intention to consider the possible imposition of retroactive refund obligations, Producers promptly moved for an evidentiary hearing in order to demonstrate the adverse effects which any such refunds would have upon the producing industry and consumers (II R. 5921). Despite the directive of the D.C. Circuit in *Skelly* for the Commission to make "a broader and more penetrating analysis" of the refund issue (329 F.2d at 250), Producers' motions for an evidentiary hearing were summarily denied. The Commission's refund order in Opinion No. 501 is based solely upon the representations contained in briefs filed by the interested parties and is entirely unsupported by any record evidence.

c. that the costs of making these sales exceeded the revenues received under the unconditioned temporary certificates.[33]

While the Commission purports to have accepted these proffered presentations at "face value" (II R. 6227), there is no rational connection between the Commission's acceptance of the facts contained in these presentations (which served to demonstrate the inequity of ordering refunds) and the Commission's ultimate conclusion that the public convenience and necessity requires that refunds be made. See *Burlington Truck Lines, Inc.* v. *United States,* 371 U.S. 156 at 167-168 (1962). On the other hand, the Commission can cite no evidence in support of its refund imposition. Rather than answer the presentations made by the Producers, the Commission now contends that the Producers only claimed "detriment, in the large, and without particularization of the facts" (Commission Br., pp. 47-48), and, therefore, cannot complain that refunds were ordered.[34]

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[33] One of the Producers, for example, offered to present evidence to demonstrate, among other things, that the imposition of retroactive refund liabilities upon his sale in question would result in confiscation of his property. This was supported by a cost-of-service presentation related to the operations of this particular producer during 1960. (II R. 6493). This basic constitutional question, raised as a reason against the imposition of retroactive refund liabilities, was not even mentioned, much less evaluated, by the Commission in its Opinion No. 501. Certainly, claims of this nature should be passed upon by the court below in the first instance, especially in light of the Commission's total disregard of such claim.

[34] The Commission suggests that because Producers argued, *inter alia,* that a retroactive repricing of gas sold under temporary certificates would greatly damage the producing industry there was no showing of individual harm. This is rank sophistry, because, as the Commission well knows, its refund orders did have an industrywide impact because virtually all companies operate some sales under temporary certificates. Producers did contend that refund orders would directly affect industrywide

The Commission also contends that the Producers accepted their temporary certificates and relied on the authorized prices only to the extent of paying state production taxes and landowner royalties. This facile argument ignores the fact that Producers relied upon the terms of the unconditioned temporary certificates to collect the price authorized, and not simply as limited authorizations to pay taxes and royalties. The Commission recognizes that taxes and royalties paid in reliance on the unconditioned temporary certificates should not be refunded because those payments were made "in light of the Commission's previous holdings, that *no* refunds would be ordered" (Commission Br., p. 47; emphasis added). This amounts to saying that a limited reprieve from liability is fair and equitable because of the Commission's many assurances that there would be *no* liability at all.

This contention may be compared to the case of an individual who receives a monthly salary and is later told that he must refund a substantial portion of it, except for the taxes he has paid on that salary — in short — that he could rely on his salary to pay taxes, but should not have relied upon it for the payment of the mortgage, the food bills and the car payments. The Commission contends that since the individual Producer did not trace the outgo of its gas revenues to the payment of particular costs (other than taxes

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"planning, budgeting and financing future drilling and production activities" because the individual members of the industry would be harmed (II R. 5925). The Commission contends that since Texaco and Humble had *de minimis* refund liabilities in *this* case, their arguments should be ignored. This is unworthy nipping that ignores the precedent flowing from *this* case to sales in other areas involved in other cases. If the Commission had been truly interested in the effect of this retroactive change in policy on producer activities, it would have convened the hearing requested by the Producers in this case.

and royalties), it should not be heard to complain.[35] Briefly, the Commission unreasonably contends that Producers could rely on their temporary certificates to pay taxes and royalties, but should not have relied upon them to pay salaries, operating expenses, drilling expenses, interest, etc.

Although we do not believe that it would be appropriate for the Court to review the Commission's exercise of its claimed refund power in the circumstances, we respectfully submit that its imposition of retroactive refund liabilities upon Producers is erroneous as a matter of law and equity.

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[35] The Commission, of course, refused to hear either group or individual cost evidence and is now using the absence of such evidence against the Producers.

III. CONCLUSION

For the reasons stated here and in our initial brief, the judgments of the Court of Appeals for the Tenth Circuit should be affirmed.

Respectfully submitted,

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